

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Interstate Power and Light Company	:	
and ITC Midwest LLC	:	
	:	07-0246
	:	
Joint Petition for Approval of Sale of	:	
Utility Assets Pursuant to Section 7-102;	:	
Transfer of Franchises, Licenses, Permits	:	
Or Rights to Own Pursuant to Section	:	
7-203; Transfer of Certificates of	:	
Convenience and Necessity Pursuant	:	
to Section 8-406; Approval of the	:	
Discontinuance of Service Pursuant to	:	
Section 8-508; and the Granting of All	:	
Other Necessary and Appropriate Relief.	:	

**INITIAL BRIEF OF THE STAFF
OF THE ILLINOIS COMMERCE COMMISSION**

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**INITIAL BRIEF OF THE STAFF OF
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Staff of the Illinois Commerce Commission (“Staff”), by and through its undersigned counsel, pursuant to Section 200.800 of the Illinois Commerce Commission’s (“Commission”) Rules of Practice (83 Ill. Adm. Code 200.800), respectfully submits its Initial Brief in the above-captioned proceeding.

I. INTRODUCTION

On April 6, 2007, Interstate Power and Light Company (“IPL”) and ITC Midwest LLC (“ITC Midwest”) (collectively, “Joint Petitioners”) filed a Verified Joint Petition to Sell Utility Assets and Discontinue Service (“Joint Petition”) with the Commission. In the Joint Petition, Joint Petitioners request that the Commission: (1) approve the sale of IPL’s Illinois-based electric transmission assets to ITC Midwest (hereafter referred to as

the “proposed Transaction”) pursuant to Section 7-102 of the Illinois Public Utilities Act (the “Act”), 220 ILCS 5/7-102; (2) transfer IPL’s franchises, licenses, permits or rights to own pursuant to Section 7-203 of the Act, 220 ILCS 5/7-203; (3) transfer the electric transmission Certificates of Public Convenience and Necessity (“Certificates”) of IPL to ITC Midwest pursuant to Section 8-406 of the Act, 220 ILCS 5/8-406; and (4) approve IPL’s discontinuance of electric transmission service provided in Illinois upon transfer of ownership to ITC Midwest pursuant to Section 8-508 of the Act, 220 ILCS 5/8-508. (Joint Petition, pp. 1-2.)

For the reasons set forth herein, Staff recommends that the Commission not approve the Joint Petitioners’ proposed Transaction as it does not meet the criteria specified in Section 7-102 of the Act.

II. PROCEDURAL HISTORY

The initial status hearing in the instant proceeding was held on May 2, 2007. At that time, Staff requested, and was granted, the opportunity to file an Answer to the Joint Petition. (Tr., p. 6.) On May 16, 2007, Staff filed its Answer to the Joint Petition, citing a number of significant concerns regarding many of Joint Petitioners’ requests. While many of Staff’s concerns were subsequently resolved, Staff maintains that Joint Petitioners’ request for an expedited proceeding before the Commission was unreasonable and substantially prejudiced Staff’s review and analysis of the proposed Transaction.

On June 1, 2007, Joint Petitioners filed a Motion in Limine seeking a ruling in advance of the evidentiary hearing that: (1) the Federal Energy Regulatory Commission (the “FERC”) has exclusive jurisdiction over issues concerning ITC Midwest’s financing;

and (2) ITC Midwest is not required to submit its affiliate interest contracts for Commission approval in the instant proceeding. The June 22, 2007 Administrative Law Judge's Ruling Upon the Petitioners' Motion in Limine ("ALJ Ruling") concluded, in summary, that: (1) because FERC has exclusive jurisdiction pursuant to the Federal Power Act over the issuances of securities by interstate wholesale electrical transmitters, ITC Midwest need not seek Commission approval of any debt issuance to consummate the purchase at issue in this proceeding; any issue regarding ITC Midwest's ability to raise the necessary funding, however, may be the subject of enquiry during discovery or the subject of evidence at trial; and (2) the subject matter of this proceeding does not include affiliated interest contracts; however, ITC Midwest is required by law to submit these contracts to the Commission for its approval when they come into existence. (ALJ Ruling, p. 9.)

On July 18, 2007, Staff filed a Motion to Compel ITC Midwest to produce full and complete responses to data requests issued by Staff pursuant to the discovery process provided for in the Commission's Rules of Practice.¹ Specifically, Staff requested that data request responses contain witness identification and verification information. At the July 23, 2007 status hearing, the Administrative Law Judge ("ALJ") ruled that the verifications should be provided to Staff pursuant to Supreme Court Rules 213 and 214, except for those data request responses that were legal objections.² (Tr., p. 68.)

Petitions for Leave to Intervene were filed by Jo-Carroll Energy, Inc. ("Jo-Carroll") on April 9, 2007, and by American Transmission Company LLC and its corporate

¹ At the July 23, 2007 status hearing, Staff orally included IPL in its request to provide the witness verification information. (Tr., p. 69.)

² The ALJ subsequently denied Staff's request for verifications for information upon which Staff witness Linkenback based his testimony. (Tr., p. 75.)

manager, ATC Management Inc., (collectively, “ATC”) on May 30, 2007, which were subsequently granted. An evidentiary hearing was held in this matter on July 26, 2007, in the Commission’s Chicago offices. Appearances were entered by counsel on behalf of IPL, ITC Midwest, Jo-Carroll, ATC, and Staff. At the hearing, Douglas C. Collins, Randy D. Bauer, and Christopher Hampsher testified on behalf of IPL. Joseph L. Welch, Jon E. Jipping, and Patricia A. Wenzel offered testimony on behalf of ITC Midwest. Carol Chinn offered testimony on behalf of ATC. Mark A. Hanson, an Economic Analyst in the Federal Energy Program of the Energy Division; Burma C. Jones, an Accountant in the Accounting Department of the Financial Analysis Division; Ronald Linkenback, an Electrical Engineer in the Engineering Department of the Energy Division; and Michael McNally, a Senior Financial Analyst in the Finance Department of the Financial Analysis Division, all provided testimony on behalf of Staff. At the conclusion of the July 26, 2007 evidentiary hearing, the matter was continued generally.

At the July 23, 2007 status hearing, Staff requested that Staff witness McNally be afforded the opportunity to file testimony in response to the rebuttal testimony of ITC Midwest witness Wenzel (Exhibit PAW 7.0), since Ms. Wenzel in effect had produced evidence in rebuttal testimony that should have properly been provided in direct testimony. The ALJ provided Staff witness McNally the opportunity to make an additional filing by close of business on August 10, 2007. (Tr., pp. 76-77.) On August 10, 2007, Staff filed a Motion for Leave to File ICC Staff Exhibit 5.0 *Instantly* (“Motion for Leave to File”) and the Rebuttal Testimony of Michael McNally. On August 13, 2007, the ALJ ruled that Staff’s Motion for Leave to File was granted and that Staff had until August 16, 2007 to file verified testimony or a verified memorandum clarifying

certain terms in Staff witness McNally's rebuttal testimony. On August 16, 2007, Staff filed the Supplemental Rebuttal Testimony of Michael McNally in response to the ALJ's clarifying questions.

On August 13, 2007, Jo-Carroll filed a Motion to Keep the Record Open in order to conduct further limited discovery and, if necessary and appropriate, to offer evidence based on the results of such discovery "with all due dispatch." On August 15, 2007, Joint Petitioners filed a response to Staff's Motion for Leave to File and Jo-Carroll's Motion to Keep the Record Open. At the August 17, 2007 emergency status hearing, the ALJ denied Jo-Carroll's Motion to Keep the Record Open as to discovery but granted it as to the ability to present evidence at the September 4, 2007 evidentiary hearing. (Id., p. 148.) The ALJ also denied Joint Petitioners' objection to Staff's Motion for Leave to File, which was treated as a request for reconsideration, but allowed the parties to conduct discovery thereon. (Id., p. 153.)

On August 20 and 22, 2007, Jo-Carroll filed the Direct Testimony and Amended Direct Testimony, respectively, of Kyle J. Buros and Michael W. Hastings. Joint Petitioners filed a Motion to Strike Jo-Carroll's Amended Direct Testimony on August 27, 2007. In a Ruling dated August 31, 2007, the ALJ denied Joint Petitioners' Motion to Strike as moot, since Jo-Carroll notified the ALJ and the parties that it intended to withdraw its pre-filed testimony.

On August 21, 2007, Staff filed its Motion for Reconsideration of a ruling made by the ALJ at the August 17, 2007 emergency status hearing regarding whether Staff's review of the proposed Transaction should include a "going-forward" analysis. In Joint Petitioners' Response to Staff's Motion for Reconsideration, ITC Midwest also included

a Motion to Strike Staff witness McNally's rebuttal testimony. In the August 31, 2007 Ruling, the ALJ granted Staff's Motion for Reconsideration, to the extent that the use of the phrase "going-forward" could be interpreted to conflict with the June 22, 2007 ALJ Ruling pertaining to the Commission's jurisdiction.

On August 28, 2007, ITC Midwest filed a Motion to Compel Staff to Respond to its Third Set of Data Requests. On that same date, Staff filed its Motion to Quash ITC Midwest's Notice of Deposition of Michael G. McNally. In a Ruling dated August 30, 2007, the ALJ granted Staff's Motion to Quash. ITC Midwest's Motion to Compel was granted with respect to only four questions in its Third Set of Data Requests to Staff. With respect to the remainder of the data requests at issue, the ALJ noted that "Staff provided answers to those questions and there is no indicia that Staff has more information".

Thirty-one minutes after the ALJ's August 30, 2007 Ruling was issued granting Staff's Motion to Quash, ITC Midwest filed its Second Notice of Deposition of Michael G. McNally. Shortly thereafter, Staff filed its Second Motion to Quash, which was granted by the ALJ in an August 31, 2007 Ruling.

A second evidentiary hearing was held in this matter on September 4, 2007, in the Commission's Chicago offices. Appearances were entered by counsel on behalf of IPL, ITC Midwest, Jo-Carroll, and Staff. At the hearing, Edward M. Rahill and Edward C. Bodmer offered surrebuttal testimony on behalf of ITC Midwest, which was admitted except for Mr. Bodmer's footnote 1, which was stricken upon Staff's motion. IPL did not offer the pre-filed Surrebuttal Testimony of Randy D. Bauer, since Jo-Carroll withdrew its pre-filed direct testimony. At the end of the second evidentiary hearing, the ALJ

denied ITC Midwest's Motion to Compel Staff's Responses to its Fourth Set of Data Requests and the Deposition of Staff witness McNally, which had been filed that morning. In denying ITC Midwest's Motion to Compel, the ALJ noted that she saw no "bad faith" on the part of Staff. (*Id.*, p. 324.)

On September 11, 2007, Staff filed its Motion for Leave to File *Instant* and the Revised Rebuttal Testimony of Michael McNally. On September 12, 2007, Staff filed its Motion for Leave to File *Instant* and the Revised Supplemental Rebuttal Testimony of Michael McNally. On September 13, 2007, Joint Petitioners filed a Response opposing both of Staff's Motions for Leave to File *Instant*.

A third evidentiary hearing was held in this matter on September 13, 2007, in the Commission's Chicago offices. Appearances were entered by counsel on behalf of IPL, ITC Midwest, and Staff. At the hearing, the ALJ denied Joint Petitioners' Motion to Strike Mr. McNally's Rebuttal Testimony. (*Id.*, p. 254.) Staff offered the Revised Rebuttal and Supplemental Rebuttal Testimony of Michael McNally, which were admitted into the evidentiary record over Joint Petitioners' objections. (*Id.*, pp. 259-260.)

III. STATUTORY AUTHORITY

A. Section 7-102 of the Act

Section 7-102 of the Act provides the criteria upon which the Commission must base its determination regarding whether it should approve the sale of any public utility assets. Section 7-102(C) of the Act provides, in relevant part, as follows:

[I]f the Commission is satisfied that such petition should reasonably be granted, and that **the public will be convenience**d thereby, the Commission shall make such order in the premises as it may deem proper

and as the circumstances may require, **attaching such conditions as it may deem proper**. . . (Emphasis added.)

B. Section 7-203 of the Act

Section 7-203 of the Act requires Commission approval of the transfer of a public utility's franchises, licenses, permits or rights to own, operate, manage or control the public utility. Section 7-203 of the Act provides, in relevant part, as follows:

No franchise, license, permit or right to own, operate, manage or control any public utility shall be assigned, transferred or leased nor shall any contract or agreement with reference to or affecting any such franchise, license, permit or right be valid or of any force or effect whatsoever, unless such assignment, lease, contract, or agreement shall have been approved by the Commission. . .

C. Section 8-406 of the Act

Section 8-406 of the Act requires a public utility to obtain a Certificate from the Commission prior to transacting any business in Illinois or beginning the construction of certain new plants, equipment, property or facilities. Section 8-406 of the Act provides, in relevant part, as follows:

(a) No public utility. . . shall transact any business in this State until it shall have obtained a certificate from the Commission that public convenience and necessity require the transaction of such business.

(b) No public utility shall begin the construction of any new plant, equipment, property or facility which is not in substitution of any existing plant, equipment, property or facility or any extension or alteration thereof or in addition thereto, unless and until it shall have obtained from the Commission a certificate that public convenience and necessity require such construction. Whenever after a hearing the Commission determines that any new construction or the transaction of any business by a public utility will promote the public convenience and is necessary thereto, it shall have the power to issue certificates of public convenience and necessity. The Commission shall determine that proposed construction will promote the public convenience and necessity only if the utility demonstrates: (1) that the proposed construction is necessary to provide adequate, reliable, and efficient service to its customers and is the least-cost means of satisfying the service needs of its customers; (2) that the utility is capable

of efficiently managing and supervising the construction process and has taken sufficient action to ensure adequate and efficient construction and supervision thereof; and (3) that the utility is capable of financing the proposed construction without significant adverse financial consequences for the utility or its customers.

D. Section 8-508 of the Act

Section 8-508 of the Act authorizes a public utility to discontinue the provision of utility service in certain situations. Section 8-508 of the Act provides, in relevant part, as follows:

Except as provided in Section 12-306, no public utility shall abandon or discontinue any service or, in the case of an electric utility, make any modification as herein defined, without first having secured the approval of the Commission, except in case of assignment, transfer, lease or sale of the whole or any part of its franchises, licenses, permits, plant, equipment, business, or other property to any political subdivision or municipal corporation of this State. . . In granting its approval, the Commission may impose such terms, conditions or requirements as in its judgment are necessary to protect the public interest. Provided, however, that any public utility abandoning or discontinuing service in pursuance of authority granted by the Commission shall be deemed to have waived any and all objections to the terms, conditions or requirements imposed by the Commission in that regard. Provided, further, that nothing in this Section shall be construed to limit the right of a public utility to discontinue service to individual patrons in accordance with the effective rules, regulations, and practices of such public utility.

E. Section 3-105 of the Act

Section 3-105 of the Act defines the term "Public utility". Section 3-105 of the Act provides, in relevant part, as follows:

"Public utility" means and includes, except where otherwise expressly provided in this Section, every corporation, company, limited liability company, association, joint stock company or association, firm, partnership or individual, their lessees, trustees, or receivers appointed by any court whatsoever that owns, controls, operates or manages, within this State, directly or indirectly, for public use, any plant, equipment or property used or to be used for or in connection with, or owns or controls any franchise, license, permit or right to engage in:

a. the production, storage, transmission, sale, delivery or furnishing of heat, cold, power, electricity, water, or light. . .

F. Section 7-101 of the Act

Section 7-101 of the Act, which governs Commission approval of affiliated interest agreements, provides, in relevant part, as follows:

(3) No management, construction, engineering, supply, financial or similar contract and no contract or arrangement for the purchase, sale, lease or exchange of any property or for the furnishing of any service, property or thing, hereafter made with any affiliated interest, as hereinbefore defined, shall be effective unless it has first been filed with and consented to by the Commission or is exempted in accordance with the provisions of this Section or of Section 16-111 of this Act. The Commission may condition such approval in such manner as it may deem necessary to safeguard the public interest. If it be found by the Commission, after investigation and a hearing, that any such contract or arrangement is not in the public interest, the Commission may disapprove such contract or arrangement. Every contract or arrangement not consented to or excepted by the Commission as provided for in this Section is void.

IV. STAFF'S POSITION

A. Operating and Maintenance Experience of ITC Midwest's Parent Company

Staff witness Linkenback testified that, pursuant to his review of the Joint Petition, Joint Petitioners' direct testimony, and Joint Petitioners' data request responses, in his opinion, ITC Midwest demonstrated that its parent company, ITC Holdings Corp. ("ITC Holdings" or "ITC"), through its existing subsidiaries, has experience operating electric transmission systems and maintaining and adequately funding electric transmission systems, and has better than average reliability compared to its peers. (ICC Staff Exhibit 3.0, p. 4.)

Mr. Linkenback stated that ITC Holdings currently serves approximately 22,000

megawatts (“MW”) of peak load and operates over 8,100 miles of transmission lines. (Exhibit JLW 2.0, p. 4.) The peak load ITC Midwest will serve is approximately 3,100 MW over 6,791 miles of line, of which 126 miles will be located in Illinois. (Joint Petition, pp. 3-4.) (ICC Staff Exhibit 3.0, p. 4.)

Mr. Linkenback noted that ITC Midwest witness Joseph L. Welch stated that ITC Holdings’ subsidiaries have “invested aggressively in the transmission grid”. (Exhibit JLW 2.0, p. 14.) In Exhibit JLW 2.1 and responses to Staff’s data requests, ITC Holdings provided evidence of reasonable funding of its transmission system. (ICC Staff Exhibit 3.0, pp. 4-5.)

Mr. Linkenback stated that information described by ITC Midwest witness Jon Jipping (Exhibit JEJ 4.0, pp. 5-8) and further explained in confidential Exhibit JEJ 4.1 indicates that ITC Holdings’ transmission system has acceptable transmission system reliability. One of the results of ITC Holdings’ adequate funding and satisfactory maintenance of its transmission system is the favorable reliability performance values compared to other transmission operators. (ICC Staff Exhibit 3.0, p. 5.)

Mr. Linkenback further testified that as part of his analysis he considered the customers that could possibly be inconvenienced by the proposed Transaction. He indicated that the Joint Petition states that ITC Midwest will not be providing retail service in Illinois and the only wholesale customer ITC Midwest will be serving in Illinois is Jo-Carroll. (Joint Petition, p. 4.) Jo-Carroll is a party to the instant proceeding. In addition, there are no independent (merchant) generation facilities connected to IPL’s Illinois transmission system and there are currently no requests to connect to IPL’s Illinois transmission system. (Responses to Staff Data Requests RDL 1.13 and RDL

1.14.) He also indicated that he reviewed the Transition Services Agreement (Exhibit 1.1-G to the Asset Sale Agreement) to verify that the service and operation of the transmission system will not be harmed immediately following the sale of the transmission assets to ITC Midwest. (ICC Staff Exhibit 3.0, p. 5.)

However, Staff witness Linkenback acknowledged that Staff witness McNally could not conclude that the proposed Transaction will convenience the public. (ICC Staff Exhibit 3.0, pp. 7-8.)

B. Transfer of IPL's Certificates and Other Relevant Documents to ITC Midwest

Staff witness Linkenback testified that Joint Petitioners requested Commission approval of the transfer of IPL's Certificates and other relevant documents to ITC Midwest pursuant to Sections 7-203 and 8-406 of the Act. He indicated that IPL provided a list of Illinois shared easements and Illinois highway and railroad permits it proposes to transfer to ITC Midwest, in response to his Data Request RDL 1.10, which he attached to his direct testimony as ICC Staff Exhibit 3.1. He further indicated that IPL provided a list of Certificates it proposes to transfer to ITC Midwest, in response to his Data Request RDL 1.8, which agrees with the information in Exhibit RDB 3.1 and Exhibit B to the Joint Petition. (ICC Staff Exhibit 3.0, pp. 6-7.) Therefore, if the Commission were to approve the proposed Transaction despite Staff's recommendation to the contrary, Staff would have no objection to the transfer or assignment of the above-mentioned Certificates and other relevant documents from IPL to ITC Midwest upon the closing of the purchase of the subject electric transmission assets.

C. IPL's Discontinuance of Electric Transmission Service

Staff witness Linkenback explained that Joint Petitioners requested that the

Commission authorize IPL to discontinue the provision of electric transmission service in Illinois pursuant to Section 8-508 of the Act and the Commission's January 3, 2007 Final Order in Docket No. 05-0835 (sale of IPL's gas and electric distribution assets to Jo-Carroll). Since ITC Midwest will acquire all of IPL's transmission assets used to provide electric transmission service in Illinois, Mr. Linkenback testified that he had no objection to allowing IPL to discontinue electric transmission service in Illinois. (ICC Staff Exhibit 3.0, p. 8.) If the Commission approves the proposed Transaction despite Staff's recommendation to the contrary, subject to any conditions imposed, Staff recommends that IPL be authorized to abandon electric transmission service in Illinois to the areas and customers served by the assets being transferred to ITC Midwest upon the closing of the purchase of such assets by ITC Midwest, pursuant to Section 8-508 of the Act, provided that all such areas and customers are offered service by ITC Midwest, with no interruption in service.

D. Asset Sale and Transition Services Agreements

Staff witness Linkenback testified that in the course of his investigation and analysis with respect to whether the proposed Transaction will convenience the public, he reviewed portions of the Asset Sale Agreement and Transition Services Agreement (Exhibit A to the Joint Petition). He stated that he had no objections or suggested changes to either document. (ICC Staff Exhibit 3.0, pp. 8-9.) However, Staff witness Linkenback's lack of objection should not be construed as a recommendation that the Commission approve or authorize either or both documents in the event the Commission approves the proposed Transaction despite Staff's recommendation to the contrary, as such action would clearly be beyond the scope of the instant proceeding.

E. Planned Projects to IPL's Illinois Transmission System

Staff witness Linkenback testified that in response to Staff Data Request RDL 1.7, IPL stated that the Midwest Independent Transmission System Operator, Inc. has no planned projects to IPL's Illinois transmission system. Therefore, there is no need for the Commission to impose the condition that ITC Midwest complete any planned projects (ICC Staff Exhibit 3.0, p. 9), if the Commission approves the proposed Transaction despite Staff's recommendation to the contrary.

F. IPL's Remaining Facilities in Illinois

Staff witness Linkenback testified that IPL will continue to own a short 12.5 kV distribution line in Illinois, if the sale of its transmission lines to ITC Midwest is approved by the Commission despite Staff's recommendation to the contrary. Per IPL's response to Staff Data Request RDL 1.12, this line will not serve any Illinois customers, but will only provide power to Sabula, Iowa, which is a municipal utility. (ICC Staff Exhibit 3.0, p. 9.)

G. Proposed Accounting Entries

Staff witness Jones reviewed Joint Petitioners' respective journal entries to record the sale of IPL's transmission assets to ITC Midwest. She found the journal entries to be in accordance with the requirements to record the sale and purchase of electric plant per 18 CFR 101, FERC's Uniform System of Accounts and 83 Ill. Adm. Code 415.10, the Uniform System of Accounts for Electric Utilities Operating in Illinois. (ICC Staff Exhibit 2.0, pp. 2-4.) Ms. Jones initially recommended that Joint Petitioners file with the Chief Clerk of the Commission, with a copy to the Manager of Accounting, copies of the actual journal entries used to record the sale and purchase of IPL's Illinois-

based transmission assets within sixty days of the closing of the proposed Transaction. She also recommended that, if the proposed Transaction has not been consummated within six months of the date of the Final Commission Order in this proceeding, Joint Petitioners file with the Chief Clerk of the Commission, with a copy to the Manager of Accounting, a letter indicating the status of the sale and purchase of IPL's Illinois-based transmission assets. (Id., p. 4.)

Joint Petitioners did not object to Ms. Jones' recommendations, but they proposed an alternative time frame within which to submit the actual journal entries. (Exhibit PAW 7.0, p. 5.) ITC Midwest proposed to file its actual journal entries within the *earlier* of either six (6) months of the close of the acquisition, or within a week of its submission of the ITC Midwest 2007 FERC Form 1 to FERC. (Id., p. 6.) IPL proposed to file its actual journal entries within six months of the closing of the sale. (Exhibit CAH 8.0, p. 2.) Ms. Jones did not object to Joint Petitioners submitting their actual journal entries no later than six (6) months after the closing of the proposed Transaction, which is concurrent with the time frame within which Joint Petitioners must submit the actual journal entries to the FERC. (Exhibit PAW 7.1.)

However, if the Commission adopts Staff's recommendation not to approve the proposed Transaction, Staff witness Jones' recommendations regarding Joint Petitioners' proposed accounting entries are moot.

H. Affiliated Interest Agreements

Staff witness Jones recommended that the Final Commission Order contain an ordering paragraph requiring ITC Midwest to submit its affiliated interest contracts to the Commission for approval, as required by Section 7-101 of the Act. (ICC Staff Exhibit

2.0, p. 7.) In the instant proceeding, ITC Midwest did not seek Commission approval of any affiliated interest agreements pursuant to Section 7-101 of the Act because: (1) it is not yet a public utility under the jurisdiction of the Commission, as defined in Section 3-105 of the Act; and (2) it currently has no affiliated interest agreements. (Id., p. 6.) ITC Midwest identified several entities with which it has relationships similar to the relationships described in Section 7-101(2)(ii) of the Act between “public utilities” and persons and corporations that are defined therein as “affiliated interests”, but it did not have any definite plans to engage in any specific transactions with the entities, nor had it made a final determination regarding whether or not it will enter into affiliated interest transactions in the future. (Id., p. 5.)

To allay any concern Staff may have about Commission access to ITC Midwest’s affiliated interest contracts in the future, the June 22, 2007 ALJ Ruling indicated that the Final Commission Order, upon certification, shall contain an ordering paragraph requiring ITC Midwest to submit all of its affiliated interest contracts to the Commission for its approval. The ALJ Ruling further indicated that such ordering paragraph shall also remind ITC Midwest that, pursuant to Section 5-202 of the Act, 220 ILCS 5/5-202, it could face a fine of up to \$2,000 per day for each day that it is in violation of that ordering paragraph, and that affiliated interest contracts that are not reviewed and approved by the Commission have no effect in Illinois. (ALJ Ruling, p. 4.)

Notwithstanding the fact that ITC Midwest testified that it will comply with Illinois legal requirements, including those related to any affiliated interest agreements that require Commission approval (Exhibit PAW 7.0, p. 7), Staff witness Jones recommended that the Final Commission Order contain an ordering paragraph requiring

ITC Midwest to submit its affiliated interest contracts to the Commission for approval, as required by Section 7-101 of the Act. (ICC Staff Exhibit 2.0, p. 7.) Such ordering paragraph should also include the reminders to ITC Midwest regarding fines and affiliated contracts that are not reviewed and approved by the Commission.

However, if the Commission adopts Staff's recommendation not to approve the proposed Transaction, Staff witness Jones' recommendations regarding ITC Midwest's affiliated interest agreements are moot.

I. Location of ITC Midwest's Office

Staff witness Jones recommended that the Commission grant ITC Midwest's request to waive the requirement, per 83 Ill. Adm. Code 250.10 and Section 5-106 of the Act, that a public utility subject to the jurisdiction and supervision of the Commission must maintain an office within the State and in such office keep all books, accounts, papers, records and memoranda as are employed in its uniform classification of accounts and/or used in connection with its utility business conducted within the State. (ICC Staff Exhibit 2.0, p. 9.) ITC Midwest proposed to maintain such records at the ITC headquarters in Novi, Michigan. (Id., p. 8.)

83 Ill. Adm. Code 250.40 states that "...upon proper application and hearing, the Commission may authorize such books, accounts, papers, records and memoranda to be kept outside of the State if the facts and circumstances warrant..." (Id.) Given that ITC Midwest will be liable for the reasonable costs and expenses associated with the audit or inspection of any books, accounts, papers, records and memoranda kept outside the State, per Section 5-106 of the Act, Staff witness Jones recommended that the Commission grant ITC Midwest's request for the waiver. (Id., p. 9.)

However, if the Commission adopts Staff's recommendation not to approve the proposed Transaction, Staff witness Jones' recommendations regarding the location of ITC Midwest's office are moot.

J. Proposed Rate Increase at FERC

Staff witness Hanson testified that Joint Petitioners must also be granted approval by FERC before the proposed Transaction can be consummated. He presented information regarding the activities transpiring at FERC for the Commission's consideration in evaluating the proposed Transaction. (ICC Staff Exhibit 1.0, pp. 2-3.)

Mr. Hanson explained that Joint Petitioners have initiated two proceedings at FERC. In Docket No. EC07-89-000, Joint Petitioners seek FERC's approval of the proposed Transaction pursuant to Section 203 of the Federal Power Act. In Docket No. ER07-887-000, permission is being sought for ITC Midwest to establish rates for transmission service and to receive revenues pursuant to those rates for transmission service provided by the Midwest Independent System Operator ("Midwest ISO") using ITC Midwest-owned transmission facilities. (*Id.*, p. 3.)

He indicated that although it does not own the transmission systems it operates, the Midwest ISO collects the charges for use of those transmission systems. These charges are determined by the area in which the transmission is located, usually coinciding with the traditional service territory of utility companies. Charges are assessed by where an electric load is consumed, i.e., the "sink". Currently, the pricing zone for the transmission assets that are the subject of this proceeding is the Alliant Energy West pricing zone of the Midwest ISO. ITC Midwest is not currently a Midwest ISO transmission owner, although its parent and affiliated transmission companies are.

ITC Midwest stated that it will become a Midwest ISO transmission owning member if the proposed Transaction is approved. If the proposed Transaction is approved, the present Alliant Energy West pricing zone will be called the ITC Midwest pricing zone. (Id., p. 4.)

Mr. Hanson further explained that as part of the process of seeking FERC approval, Joint Petitioners have filed a rate proceeding at the FERC, i.e., FERC Docket No. ER07-887-000. In that docket, Joint Petitioners are seeking approval of a transmission formula rate to be determined through Attachment O of the Midwest ISO tariff. Attachment O is the section of the Midwest ISO tariffs that spells out the method of determining transmission charges. ITC Midwest is asking that the FERC grant it the Midwest ISO allowed return on equity, i.e., 12.38%, as a base return on equity. However, ITC Midwest is also seeking two adders to the base return on equity. ITC Midwest is seeking a 50 basis point adder for membership in the Midwest ISO. ITC Midwest is also seeking a 100 basis point adder for its status as an independent transmission company. The FERC has allowed these “incentives” to the base return on equity in other instances. (Id., pp. 4-5, 6-7.)

Mr. Hanson pointed out several differences between IPL’s and ITC Midwest’s Attachment O. For example, IPL does not receive the aforementioned “incentives” to the base return on equity. Also, ITC Midwest is proposing to use a capital structure of 60% equity and 40% debt. The capital structure used for IPL (called Alliant Energy West on Attachment O) is 51% common equity, 8% equity in the form of preferred stock, and 41% long term debt. ITC Midwest is seeking a return on equity of 13.88% as opposed to the 12.38% IPL receives on common equity. IPL receives a return of 6.81%

on its debt. At this point, the cost of debt for ITC Midwest is not known since it has not issued the debt it will be using to finance the proposed Transaction. IPL receives a return of 8.11% on the preferred stock component of its capital structure. ITC Midwest does not propose using preferred stock in its capital structure. (Id., p. 7.)

With respect to the prospective rate impacts of the proposed Transaction, Mr. Hanson testified that since ITC Midwest has yet to issue debt, it is difficult to state the final rate since the cost of debt is unknown. However, ITC Midwest has proposed to use a capital structure higher in common equity than IPL. Since common equity typically has a higher return than debt or equity in the form of preferred stock, upward pressure on transmission rates would result in the event FERC approved the proposed capital structure. Additional upward pressure would result if FERC approved the return on equity adders being sought by Joint Petitioners. (Id., p. 8.)

Joint Petitioners addressed potential rate impacts in the FERC filing, by offering to keep transmission rate recovery at present levels until January 1, 2009. The rates to be charged in 2009 would be based on the inputs into the formula rate from the 2008 FERC Form 1. The rates to be charged in 2010 would be based on the inputs into the formula rate from the 2009 FERC Form 1. However, ITC Midwest proposed that, in 2010, rates would also include a true-up of 2008 rates to collect any under-recovery of 2008 revenue requirements due to rates being unchanged in 2008. Therefore, rates are not being “frozen” per se, but rather, any rate changes in 2008 are being deferred until 2010. (Id.)

K. Financial Strength of ITC Midwest

Staff witness McNally testified in direct testimony that, in order to determine

whether the public will be inconvenienced by the proposed Transaction, the Commission should consider whether ITC Midwest and its parent company, ITC Holdings, are capable of financing the proposed acquisition without significant adverse consequences to ITC Midwest or its Illinois customers. He referred to the direct testimony of ITC Midwest's witness Welch, who made several claims with respect to the financial strength of ITC Midwest and its corporate affiliates. Specifically, Mr. Welch stated that "[m]aking the required investment in IPL's transmission system is consistent with what ITC Transmission and METC have done in Michigan, where ITC has demonstrated its ability to finance, plan, and construct needed transmission improvements;" "[t]he transaction would result in an independent transmission company with....capital available to invest in needed infrastructure;" and "ITC has a strong financial profile (strong balance sheet and good cash flow) and investment grade ratings." Mr. McNally opined that, unfortunately, Mr. Welch's testimony provided neither support for those claims nor any explanation as to how the financial position of ITC Midwest's affiliates translates into the ability of ITC Midwest to fund the proposed Transaction and provide reliable and efficient electric transmission service. (ICC Staff Exhibit 4.0, pp. 3-4.)

Mr. McNally testified that no specific facts were provided concerning the stand-alone financial condition of ITC Midwest and its ability to fund the proposed Transaction. Indeed, ITC Midwest's response to a Staff data request indicated that, as a newly-formed subsidiary of ITC Holdings, there were no historical or current ITC Midwest operations or assets; thus, no current or historical financial statements were provided for ITC Midwest. Its response further stated that ITC Midwest has not yet developed forecasted financial statements, either. (Id., p. 5.)

Mr. McNally testified that while he was unable to obtain information with regard to ITC Midwest's financial strength, he was able to obtain some information with regard to the financial strength of ITC Midwest's affiliates through several data requests he sent to Joint Petitioners. Nevertheless, that information was almost entirely limited to historical data (e.g., 2005 and 2006 10-Ks and references to previous transmission investments) and credit ratings reports. He concluded that, essentially, Joint Petitioners' "demonstration" that ITC Midwest is financially capable of funding the proposed Transaction without adverse effect on itself or its customers rests on ITC Midwest's affiliates' modest degree of financial strength and prior ability to obtain funding. (Id., p. 4.)

Mr. McNally explained that, for example, in its response to a Staff data request asking ITC Midwest to demonstrate that it is capable of financing this acquisition without significant adverse financial consequences to ITC Midwest or its Illinois customers, ITC Midwest stated that previous debt and equity offerings of ITCTransmission, METC, and ITC have been well received in the investment community, as evidenced by their "positive" Moody's Investors Service ("Moody's") and Standard & Poor's ("S&P") credit ratings. The response further noted that it is ITC Midwest's belief that ITCTransmission's and METC's rate constructs played a significant role in those results, and since ITC Midwest seeks a similar rate construct for itself, it expects a similar reception to its capital offerings. (Id., pp. 4-5.) However, past performance is certainly not necessarily indicative of future results. Furthermore, even the financial strength of ITC Midwest's affiliates, which Joint Petitioners tout, raised concerns with regard to the public convenience requirement, since the proposed Transaction would transfer

ownership of Illinois utility assets to a highly leveraged company. (Id., pp. 9-10.)

Mr. McNally stated that he had concerns that the proposed Transaction could have potential adverse consequences for ITC Midwest or its Illinois customers. As previously stated, Joint Petitioners' argument in support of the proposed Transaction relied heavily on the financial strength of ITC Midwest's affiliates. However, ITC Midwest's affiliates demonstrated only a modest degree of financial strength, not a superior degree of financial strength. Indeed, ITC Holdings maintains a lower credit rating than that of the current owner of the transmission assets, IPL, or its parent, Alliant Energy Corporation. (Exhibit PAW 7.0, pp. 20-22.) A lower credit rating means a more restricted ability to raise capital necessary to provide adequate and reliable utility services. Nevertheless, a lower credit rating would not necessarily inconvenience the public if it also resulted in a lower cost of capital. That is, in exchange for the greater risk to the quality of utility service, rate payers were charged a lower cost of capital. Unfortunately, ITC Midwest does not offer such a trade off. Although its creditworthiness is likely to be no better than IPL's (Id., p. 22), ITC Midwest is seeking a higher cost of capital (ICC Staff Exhibit 1.0, pp. 7-8).

Mr. McNally testified that, moreover, according to ITC's 2006 10-K, ITC's capital structure is highly leveraged, with approximately 30% common equity and 70% debt, which could impair its ability to raise capital, making ITC Midwest's heavy reliance on ITC decidedly risky. Indeed, ITC's 2006 10-K explicitly states, "We are highly leveraged and our dependence on debt may limit our ability to pay dividends and/or obtain additional financing." It further warns that "[o]ur indebtedness will have the general effect of reducing our flexibility to react to changing business and economic conditions

insofar as they affect our financial condition...” and “the incurrence of additional indebtedness would increase the leverage-related risks described herein.” Mr. McNally concluded that these statements raise significant concerns regarding whether or not the proposed Transaction would convenience the public. (ICC Staff Exhibit 4.0, p. 9.)

Mr. McNally concluded that based on the limited information available to him at that time with regard to ITC Midwest’s financial condition, he could not conclude that ITC Midwest is capable of financing the proposed Transaction without significant adverse consequences to ITC Midwest or its customers and, thus, he could not recommend that the Commission find that the Joint Petition is consistent with the requirements of Sections 7-102 and 8-406 of the Act. (Id., p. 10.)

In revised rebuttal testimony, Staff witness McNally updated his evaluation of the financial strength of ITC Midwest to reflect the additional information provided in ITC Midwest witness Wenzel’s rebuttal testimony as it pertained to the proposed Transaction. He indicated that his primary concerns with the Joint Petitioners’ initial filings were the lack of information regarding the details of the proposed Transaction as well as the marginal financial position of ITC Holdings, and the possible resulting implications for ITC Midwest and its customers. (ICC Staff Exhibit 5.0R, p. 1.)

Mr. McNally testified that while Ms. Wenzel provided many of the details regarding the proposed Transaction that were missing from the previous filings, she provided little to allay his concerns about ITC Holdings’ financial strength. He stated that ITC Holdings was, and would remain, highly leveraged and had a Moody’s credit rating of only one notch above junk status. In fact, Ms. Wenzel testified that ITC Holdings had no plans to realign its 70% debt capital structure. Moreover, ITC

Midwest's finances were still reliant on both ITC Holdings and favorable FERC rate treatment. Even if ITC Midwest were to receive favorable rate treatment from FERC, ITC Midwest will still remain subject to the influence of ITC Holdings. (Id., p. 2.)

Given the evidence presented since his direct testimony filing, Mr. McNally concluded that the proposed Transaction, if approved, would likely have adverse impacts on ITC Midwest and its customers. Thus, he opined that ITC Midwest was not capable of financing the proposed Transaction without significant adverse consequences to ITC Midwest or its customers and he recommended that the Commission reject the Joint Petition as inconsistent with the public convenience requirement of Sections 7-102 and 8-406 of the Act. (Id.)

Mr. McNally explained that the purpose of his original supplemental rebuttal testimony was to clarify certain statements in his rebuttal testimony as requested in the ALJ's August 13, 2007 Ruling. In his revised supplemental rebuttal testimony, he updated his supplemental rebuttal testimony to reflect the revisions made in his revised rebuttal testimony. (ICC Staff Exhibit 6.0R, p. 1.)

He stated that the ALJ's August 13, 2007 Ruling requested testimony or a memorandum explaining:

what an "FFO coverage ratio" is, and its significance, as well as explaining what legal means, by which, ITC Midwest would be able to demonstrate to the Commission's satisfaction that ITC Holdings has reestablished an FFO coverage ration [sic] of two to one or greater, or that such payment meets the conditions set forth in Section 7-103(2) of the Public Utilities Act. Also, it is unclear what the phrase "such payment" refers to. (See, Staff Ex. 5.0 at lines 109-119).

(Id., pp. 1-2.)

Mr. McNally explained that, generally speaking, the funds from operations (“FFO”) coverage ratio equals the ratio of a company’s operating cash flow before interest payments and changes in working capital to its interest expense. This ratio measures how many times a company’s interest expense could be paid from the cash its business operations generate (as opposed to cash raised through the sale of securities or property). Thus, this ratio measures the safety margin a company has, if any, to be able to meet its fixed financial payment obligations during business down-turns or other emergencies. For example, a company with an FFO interest cover ratio of exactly 1:1 is generating just enough cash to cover its interest payments, but would quickly default if business conditions worsened. As a rule, the higher the variability of a company’s operating cash flow, the higher the FFO coverage it should maintain to ensure that it can always meet its interest obligations. (Id., p. 2.)

Mr. McNally further explained that the Indenture between ITC Holdings and BNY Midwest Trust Company prohibits ITC Holdings and its subsidiaries from issuing new debt if ITC Holdings’ consolidated FFO coverage ratio falls below 2:1. Specifically, ITC Holdings’ Indenture defines the FFO coverage ratio as:

“FFO Coverage Ratio” of any Person means, for any period, the ratio of (1) Consolidated FFO plus the consolidated interest expense of the Company and its Subsidiaries, to the extent paid in cash, to (2) Consolidated Interest Expense plus the consolidated allowance for funds used during construction, debt portion, of the Company and its Subsidiaries, each determined for such period.

In the event that the Company or any of its Subsidiaries incurs, assumes, guarantees or redeems any Indebtedness (other than revolving credit borrowings under existing credit facilities) or issues preferred stock subsequent to the commencement of the Reference Period for which the FFO Coverage Ratio is being calculated but prior to the date on which the event for which the calculation of the FFO Coverage Ratio is made (the “Calculation Date”), which Indebtedness or preferred stock remains

outstanding on the Calculation Date, then the FFO Coverage Ratio shall be calculated giving pro forma effect to such incurrence, assumption, guarantee or redemption of Indebtedness, or such issuance or redemption of preferred stock, and to the discharge of any other Indebtedness or preferred stock repaid, repurchased, defeased or otherwise discharged with the proceeds of such new Indebtedness or preferred stock, as if the same had occurred at the beginning of the applicable Reference Period.

For purposes of making the computation referred to above, acquisitions that have been made by the Company or any of its Subsidiaries, including through mergers or consolidations and including any related financing transactions, during the Reference Period or subsequent to such Reference Period and on or prior to the Calculation Date shall be deemed to have occurred on the first day of the Reference Period.

The Indenture defines a “Person” as:

“Person” means any individual, corporation, partnership, joint venture, limited liability company, association, company, trust, unincorporated organization or government or any agency or political subdivision thereof.

The Indenture defines the “Consolidated FFO” as:

“Consolidated FFO” means, for any period, the sum, without duplication, of: (1) Consolidated Net Income for such period; (2) the consolidated interest expense of the Company and its Subsidiaries that was capitalized during such period; (3) the consolidated deferred taxes of the Company and its Subsidiaries for such period; (4) consolidated depreciation, amortization and other non-cash charges, and extraordinary charges of the Company and its Subsidiaries that were deducted in determining such Consolidated Net Income for such period; (5) the consolidated allowance for funds used during construction of the Company and its Subsidiaries for such period; and (6) any non-recurring fees, charges or other expenses (including acquisition integration costs and fees) incurred in connection with the Acquisition within one year of the initial issuance of Securities under this Indenture, in any such case to the extent such fees, charges or other expenses were deducted in computing such Consolidated Net Income, provided that Consolidated FFO shall exclude changes in the Company’s working capital on a consolidated basis for such period, in each case, determined in accordance with generally accepted accounting principles.

(Id., pp. 2-5.)

Mr. McNally concluded by stating that, if necessary, ITC Midwest could demonstrate to the Commission that ITC Holdings had re-established an FFO coverage of

2:1 or greater, by demonstrating in a quarterly report how the reported coverage ratio was calculated, using data from ITC Holdings' quarterly financial reports to the SEC (i.e., 10-Qs and 10-Ks). Further, ITC Midwest could be required to provide a verified statement from its Chief Financial Officer attesting to the accuracy of the FFO coverage ratio and the underlying data. (*Id.*, p. 5.)

V. THE ISSUE BEFORE THE COMMISSION AND THE APPLICABLE LAW

A. The Issue

The issue before the Commission in the instant proceeding is whether, pursuant to Section 7-102 of the Act, the public will be inconvenienced by the sale of IPL's Illinois transmission assets to ITC Midwest.

B. The Applicable Law

The public convenience criterion in Section 7-102 of the Act has been interpreted by Illinois Appellate Courts, the Illinois Supreme Court, and the Commission.

1. Appellate Court and Illinois Supreme Court Decisions

In *Commonwealth Edison Company v. ICC* (1989), 181 Ill. App. 3d 1002, Commonwealth Edison Company ("ComEd") proposed to sell property which contained a fen. Both a conservation district and the prospective buyer, a housing developer, were interested in the property. The developer offered the highest bid, which was accepted by ComEd. The Commission then refused to permit the proposed sale. On appeal, the court ruled that the Commission exceeded its statutory authority when it inquired into the environmental impact of the residential development on the fen. The court determined that the environmental impact of a residential development was not within the particular expertise of the Commission, which improperly relied upon the

environmental implications of the proposed sale in making its final decision. The Commission did not examine the sale in a public utility service context, but, instead, in an environmental impact context. The appellate court stated:

We believe the Commission exceeded its statutory authority when it inquired into the environmental impact of the residential development on the fen. We do not agree with defendants' position that the public convenience factor applies to the public welfare in general. Instead, "public convenience" must be read in the context of the specific purpose of the Act, namely, to provide the public with efficient utility service at a reasonable cost. Our supreme court has stated that the public convenience factor, when read in the context of the Act, includes such factors as **costs to customers, simplification of utility service, operating costs, facilities planning, and proximity of service territories.** (*Illinois Power Co. v. Illinois Commerce Comm'n* (1986), 111 Ill. 2d 505, 512, 514.) Each of these factors specifically relates to the regulation of public utility service. As such, these factors come within the particular expertise of the Commission. (Emphasis added.) 181 Ill. App. 3d 1002, 1008.

In *Illinois Power Company v. ICC* (1986), 111 Ill. 2d 505 ("Illinois Power decision"), Illinois Power Company ("Illinois Power") filed a petition under Section 27 of the Act, Ill. Rev. Stat. 1981, ch. 111 2/3, para. 27,³ seeking approval of a proposed merger with Mt. Carmel Public Utility Company ("Mt. Carmel"). Central Illinois Public Service Company, which was also interested in acquiring Mt. Carmel, intervened and presented evidence against the proposed merger. The Commission denied the petition and the trial court affirmed the Commission's denial. The appellate court reversed the trial court judgment on the grounds that the Commission exceeded its authority by requiring the proposed merger to be superior to alternative proposals. The Illinois Supreme Court reversed the appellate court, stating:

The purpose of the Illinois Public Utilities Act is "to assure the provision of efficient and adequate utility service to the public at a reasonable cost."

³ The language in Section 27 is virtually identical with the language which now appears in Section 7-102 of the Act.

(Seafarers Union v. Commerce Com. (1970), 45 Ill. 2d 527, 535; Village of Hillside v. Illinois Commerce Com. (1982), 111 Ill. App. 3d 25, 36.) It is reasonable and desirable that the Commission should be allowed to consider the comparative advantages of service provided by a utility other than the petitioning utility, and the respective costs to customers, when weighing the question of public convenience in a proceeding under the Public Utilities Act. A common understanding of convenience is “a favorable or advantageous condition, state, or circumstance.” (Webster’s Third New International Dictionary 497 (1961).) **The public-convenience standard should not be construed to prohibit the Commission from considering an alternative proposal that is advantageous and indeed may be preferable for the public convenience.** (Emphasis added.) 111 Ill. 2d 505, 512.

Furthermore, the Supreme Court concluded that the Commission’s finding that the Illinois Power/Mt. Carmel merger would not serve the public convenience was not contrary to the manifest weight of the evidence. The Supreme Court noted:

The Commission judged that the **contiguity of the properties, simplification of electric service facility planning, fairness and reasonableness to shareholders, interests of the ratepayers, and incremental cost of service** were relevant to the determination of whether Illinois Power’s proposal would convenience the public. (Emphasis added.) 111 Ill. 2d 505, 514.

While the language highlighted above provided some guidance to Staff in its review of the proposed Transaction, Staff used information specific to the instant proceeding in conducting its Section 7-102 of the Act public convenience analysis. As the Illinois Supreme Court noted in the *Illinois Power* decision:

The legislature, apparently recognizing that it would be impractical to attempt to provide precise criteria to be considered in every transaction regulated under section 27, gave the Commission broad discretion to decide whether a proposed transaction should be approved when it set “public convenience” as the standard for approval. 111 Ill. 2d 505, 511.

In Klopf v. Illinois Commerce Com. (1977), 54 Ill. App. 3d 491, the Commission denied the petition of a railroad public utility that proposed the sale of a tract of land to adjoining landowners. The Commission approved the opposing petition of the Illinois

Department of Conservation, which enabled the Department to begin condemnation proceedings so that the property might be put to public use. The appellate court was asked to decide whether the Commission had exceeded its authority under Section 27 by considering whether the condemnation of the land would better serve the public interest. The appellate court held that the Commission had discretion to look beyond the railroad's petition to sell the land and determined that the public convenience would be "better served" by the plan of the Department of Conservation to use the land as a nature trail.

Furthermore, IPL and ITC Midwest are the parties with the burden to demonstrate that their proposal is in the "better" public interest. Where a party seeks affirmative relief by filing a petition, that party bears the burden of proof. The Commission's practice of assigning the burden of proof to petitioners in Commission proceedings is consistent with Illinois law, which confirms that the petitioner or party seeking affirmative relief bears the burden of proof. See Bell v. School Dist. No. 84 (1950), 407 Ill. 406, 416-17, 95 N.E.2d 496, 501.

2. Commission Orders

In a variety of cases, the Commission has discussed the meaning and application of the public convenience criterion. In Docket No. 03-0657 (AmerenCIPS and AmerenUE gas asset transfer), the Commission determined that the public convenience criterion had been met because "neither the ratepayers of AmerenUE nor of AmerenCIPS are likely to be adversely affected in the event the proposed asset transfer and reorganization takes place", and because "it appears likely that certain efficiencies will accrue should the proposed reorganization occur, some of which are

expected to benefit ratepayers.” In Docket No. 01-0390 (Peoples real estate sale), the Commission found that the public was inconvenienced since “Peoples contended, and the evidence presented established, that the sale of the Property would neither interfere with Peoples’ operation of its public utility business nor with the performance of its duties to the public. The evidence also established that the real estate in question is not in use.” In Docket No. 04-0602 (Peoples and North Shore authorization to borrow and lend funds), the Commission determined that “[t]he authorization to borrow and lend funds between Peoples Gas and North Shore will be in the public interest in that it will facilitate the operation of Peoples Gas and North Shore, and, therefore, the public will be inconvenienced thereby.”

In Docket No. 02-0352, the City of Pekin sought authority pursuant to 735 ILCS 5/7-102 to institute eminent domain proceedings against Illinois-American Water Company. Here, the Commission concluded that the City of Pekin failed in its burden of proving that granting eminent domain authority would “better serve” the public interest. (See Docket No. 02-0352, Order, entered January 22, 2004, pp. 59-62.) The appellate court affirmed the Commission’s decision. No. 3-04-0227 (unpublished order under Supreme Court Rule 23.)

In Docket No. 92-0404, Illinois Power sought an Order pursuant to Sections 7-101 and 7-102 of the Act authorizing an investment in an unregulated wholly-owned subsidiary, the execution and performance of an agreement with that subsidiary and the transfer of certain assets in connection therewith, and the accounting treatment of the investment in and transactions with that subsidiary. With respect to the public convenience standard under Section 7-102, the Commission stated:

Based on its review of Section 7-102, the caselaw relating thereto, past Commission decisions and the positions of the parties in this proceeding, the Commission believes that it has broad discretion to decide whether a proposed transaction under Section 7-102 is in the public convenience, and whether conditions should be attached to any approval thereof, provided that its analysis is relevant to the policies and purposes of the Act, such as the provision of adequate, efficient, reliable, environmentally safe and least-cost public utility services at reasonable cost. (220 ILCS 5/1-102).

In this context, the Commission believes it is proper to consider proposals of record pertaining to such issues as **benefits to and adverse impacts on ratepayers**, and restrictions or conditions relating thereto, provided that such considerations are relevant to the purposes and policies of the Act.

In this docket, on the cost side, the costs or harms identified in the Staff cost benefit analysis relate primarily to financial concerns addressed by Mr. Pregozen. . . On the benefit side, the record indicates that while there are some potential benefits to IP through IP Group's participation in the independent power market, Staff and CUB are correct that these purported benefits are not likely to occur in the near future, and are difficult to measure. However, the Commission does not agree that approval to invest in IP Group may only be granted if the "heavy preponderance" of the evidence indicates that benefits are greater or "much greater" than costs. The Commission does not view this standard as supported by caselaw or past Commission decisions.

Based on the statute, court decisions, Commission orders and the record developed in this docket, **the Commission believes that for purposes of this proceeding, if the evidence indicates, at any given level of investment, that there is no reasonable likelihood of adverse impacts on ratepayers, or that the benefits to ratepayers are reasonably likely to equal or exceed the costs or harms to ratepayers, then approval to invest in IP Group would be appropriate.** (Emphasis added.) 1993 Ill. PUC LEXIS 458 * 183; 147 P.U.R.4th 225.

Thus, previous Commission Orders concluded that while the public convenience criterion does not necessarily require the benefits of a proposed transaction to *outweigh* the costs, it does require that the benefits of the proposed transaction are *at least equal* to the costs.

As discussed below, the Joint Petitioners' proposed Transaction fails the public

convenience test, as established by the courts and the Commission in the preceding cases.

VI. ARGUMENT

A. The Public Will Not be Convenienced if ITC Midwest is “Pillaged” as a Result of ITC Holdings’ Weak Financial Position

Using the guidance provided by Illinois case law and Commission Orders, Staff witness McNally reviewed the proposed Transaction by examining whether ITC Midwest not only would be capable of purchasing IPL’s Illinois transmission assets, but also whether it would have the financial means with which to operate and maintain those assets.

ITC Holdings has no operations and generates no revenues itself. Rather, to pay its expenses, including its significant fixed debt obligations, ITC Holdings relies entirely on the funds it receives, in the form of dividend payments, from its operating subsidiaries. (Tr., p. 319.) In its brief history, ITC Holdings has experienced a favorable economic, business, and regulatory climate; thus, ITC Holdings has not encountered problems with this business model. (Exhibit PAW 7.0, p. 13.) However, if economic, business, and regulatory conditions worsen, ITC Holdings could experience financial hardships that would increase its cash needs, and it would likely need to turn to its sole source of internal funding, its operating subsidiaries, for the additional necessary cash flow. Because of its high degree of leverage (70% debt), ITC Holdings has little margin for error; thus, such a scenario is far from improbable. (ICC Staff Exhibit 5.0R, p. 2.) In fact, ITC Holdings’ management acknowledged, “We are highly leveraged and our dependence on debt may limit our ability to pay dividends and/or obtain additional financing.” (ICC Staff Exhibit 4.0, p. 9.)

Because the operating subsidiaries do not have unlimited cash flows, they may not be able to meet ITC Holdings' demands without significant adverse consequences to ITC Midwest or its customers. That is, without barriers, such as contractual or regulatory restrictions, a holding company can force its subsidiaries to surrender funds to the parent that the subsidiaries might need to provide safe, adequate, reliable, and least-cost service. There are no barriers preventing ITC Holdings from draining ITC Midwest of funds that it might need to provide safe, adequate, reliable, and least-cost service. All the Commission has as evidence that this business model will not negatively affect ITC Midwest or its customers are the Joint Petitioners' assurances and a very short history under a favorable economic, business, and regulatory climate. However, as countless financial documents attest, past performance is not necessarily indicative of future results. Moreover, ITC Holdings' very short history has not demonstrated how ITC Holdings would react if economic, business, or regulatory conditions worsen, as they inevitably do from time to time. Indeed, ITC Holdings' own management stated, "[o]ur indebtedness will have the general effect of reducing our flexibility to react to changing business and economic conditions insofar as they affect our financial condition." (*Id.*) In addition, as the ALJ noted, "Staff has had many situations where they've uncovered holding companies pillaging the regulat[ed] utility... sometimes Staff has uncovered these situations where it was really too late to do anything about it." (Tr., p. 243.) As with this case, those companies, too, undoubtedly argued that they had a strong financial position when they requested certification from the Commission. That is precisely why the Commission cannot just accept the Joint Petitioners' assurances that ITC Holdings would not harm ITC Midwest, however

sincere and well-intentioned those assurances might be, but rather must take action to prevent such a scenario from occurring again.

As such, Staff argues that the proposed Transaction will not convenience the public.

B. The Public Will Not be Convenienced by the FFO Interest Coverage Requirement in ITC Holdings' Indenture That Would Restrict ITC Midwest's Ability to Issue Debt

The Indenture between ITC Holdings and BNY Midwest Trust Company prohibits ITC Holdings and its subsidiaries from issuing new debt, with certain exceptions not related to ITC Midwest, if ITC Holdings' consolidated FFO coverage ratio falls below 2:1. The inability of a public utility to raise additional capital, should it need to do so, would certainly not convenience the public. Joint Petitioners' own documentation indicates that such a restriction presents a grave concern in the instant proceeding. Specifically, S&P states that it anticipates that ITC Midwest will need to raise external capital to finance its projected capital expenditures (Exhibit PAW 7.6, p. 3), while Credit Suisse forecasts that ITC Holdings' FFO interest coverage ratio will fall below 2.0 in ITC Midwest's very first year of operations and remain below 2.0 for as long as Credit Suisse forecasts (i.e., through 2012) (Exhibit PAW 7.2, p. 9). Thus, those analyses indicate that ITC Midwest will need to raise external capital but, due to the FFO interest coverage restriction in ITC Holdings' Indenture, might be unable to raise debt. That limitation, together with ITC Holdings' warning about its ability to obtain additional financing (ICC Staff Exhibit 4.0, p. 9), suggests that ITC Midwest might not be able to meet its capital expenditure needs in the foreseeable future.

As such, Staff argues that the proposed Transaction will not convenience the public.

C. The Operating and Maintenance Experience of ITC Holdings is Meaningless if ITC Midwest Does Not Have Adequate Financial Resources

Consistent with Illinois case law and Commission Orders, Staff witness Linkenback examined whether ITC Midwest had demonstrated that its parent company, ITC Holdings, through its existing subsidiaries, had experience operating electric transmission systems and maintaining and adequately funding electric systems, and had better than average reliability compared to its peers. While Mr. Linkenback believed at the time his direct testimony was filed that the proposed Transaction inconvenienced the public, he qualified his opinion by acknowledging Staff witness McNally's opposition based on the financial strength of ITC Midwest. (ICC Staff Exhibit 3.0, p. 4.)

Staff witness McNally continues to oppose the proposed Transaction based on his concerns regarding the potential ownership of the transmission assets by a highly-leveraged company with a credit rating lower than the current owner. Staff witness Linkenback's regard for ITC Midwest's ability to operate and maintain the transmission assets is meaningless without ITC Midwest's corresponding financial capabilities. As such, Staff argues that the proposed Transaction will not convenience the public.

D. The Public Will Not be Convenienced by ITC Midwest's Proposed Rate Increase at FERC

Staff witness Hanson explained in great detail the activities transpiring at FERC for the Commission's consideration in evaluating the proposed Transaction. Most significantly, he compared the financial differences between the present owner of the

transmission assets, IPL, and those of the proposed owner, ITC Midwest. For example, ITC Midwest is proposing to use a capital structure of 60% equity and 40% debt for rate setting. In contrast, the capital structure for IPL is 51% common equity, 8% equity in the form of preferred stock, and 41% long term debt. Furthermore, ITC Midwest is seeking a return on equity of 13.88% as opposed to the 12.38% IPL receives on common equity. Mr. Hanson explained that ITC Midwest's higher return on equity proposal and ITC Midwest's higher requested equity ratio both serve to increase transmission rates.

While ITC Midwest is proposing not to charge the higher transmission rates until January 1, 2009, it has proposed to accrue the difference between the higher and lower rates in 2008 and begin recovering that un-recovered amount beginning January 1, 2010. Furthermore, ITC Midwest is suggesting that new transmission needs to be built, which would push transmission rates up. ITC Midwest is proposing a formula rate process at FERC under which any new assets will be reported on FERC Form 1 and automatically reflected in the transmission rate.

As such, Staff argues that ITC Midwest's proposed rate increase at FERC will not convenience the public. In fact, the transmission customers presently being served by IPL will be better off continuing to be served by IPL.

E. The Public Will Not be Convenienced by the Loss of ATC's Involvement

Carol M. Chinn, Vice President and Chief Operating Officer at ATC, testified that "ATC monitors and controls the operation of a portion of the facilities that are being transferred by IPL to ITC, generally those operating at 69 kV and above." (ATC Exhibit 1.0, p. 2.) She further testified that because of recent legal and regulatory changes in the energy industry, ATC concluded that, in the long term, it would not provide operating

services for transmission assets owned by others. Accordingly, ATC does not anticipate that it will continue to provide this service beyond 18 months following the closing of the proposed Transaction, if approved by the Commission and other regulatory agencies. (*Id.*, pp. 3-5.) Joint Petitioners' witness Welch responded that when the current contract with ATC expires, if ATC no longer provides those services, ITC Midwest will either perform those tasks itself or contract with another entity to do the same. (Exhibit JLW 6.0, p. 5.)

Staff argues that the lack of an agreement with ATC will not convenience the public. Staff understands that ATC made a considered business decision in this regard. However, Staff does not understand why ITC Midwest, having indicated no experience in providing such services, has made no decision whatsoever to fill a void that it knows with certainty will exist in the very near future.

F. The Public Will Not be Convenienced by ITC Midwest's Proposed Condition of Approval

At the third evidentiary hearing in the instant proceeding, ITC Midwest entered Staff's response to ITC Midwest's proposed condition of approval into the evidentiary record as ITC Midwest Cross Exhibit 1.0. (Tr., pp. 262-263.) ITC Midwest's proposed condition of approval consists of its submitting verified copies of various publicly available documents (e.g., FERC Form 1; FERC Form 1/ 3 Q; Securities and Exchange Commission Form 10-q; and Securities and Exchange Commission Form 10-k) and its proprietary quarterly and annual GAAP financial statements to the Manager of the Finance Department of the Commission for three years after the closing of the proposed Transaction. However, Staff believes that the proposed condition alone would not provide sufficient protection to ITC Midwest to rectify the shortcomings of the proposed

Transaction, as it fails to establish performance standards and includes no penalty or remedy for any problems that may arise. (ITC Midwest Cross Exhibit 1.0, p. 1.)

Staff argues that any condition that the Commission might impose must set standards of performance and include consequences for failure to meet those standards. Performance standards can include either operating standards or financial standards, or both. ITC Midwest's proposed condition of approval merely provides for financial reporting, not standards. Although financial standards do not directly measure the adequacy, efficiency, reliability, and safety of utility service required by Section 1-102 of the Act, financial standards are useful in that they measure the adequacy of the utility's financial strength, flexibility, and resources to fund the operation, maintenance, and construction of facilities necessary to provide adequate, efficient, reliable, safe, and least-cost utility service. While financial reports would be a useful component in a condition designed to ensure that ITC Midwest meets its obligations to provide adequate, efficient, reliable, safe, and least-cost utility service, financial reports generally, and those described by ITC Midwest in particular, are not sufficient on their own. Further, the three-year reporting period is too short to set a base line picture of ITC Midwest's operating and financial condition, since it has no history as a stand-alone entity. (*Id.*, pp. 1-2.)

As such, ITC Midwest's proposed condition of approval will not convenience the public and should be rejected by the Commission.

G. The Public Will Not be Convenienced by IPL's Tax Deferral

From the outset of the instant proceeding, Joint Petitioners have insisted on an "expedited proceeding". The sole justification for this race against time is the Joint

Petitioners' contention that they absolutely must close the sale by December 31, 2007 in order to reap certain undisclosed tax benefits pursuant to Section 909 of the American Jobs Creation Act of 2004 ("Section 909").⁴ Section 909 would allow the seller, IPL, to elect to recognize all or part of its qualified gain from the proposed Transaction ratably over an eight-year period beginning with the year that includes the date of the "qualifying electric transmission transaction". In order to qualify for the tax deferral, IPL would have to use the entire amount realized from the sale of approximately \$750 million within four years from the date of closing to purchase property for electric generation, transmission, or distribution, or for natural gas production or distribution.

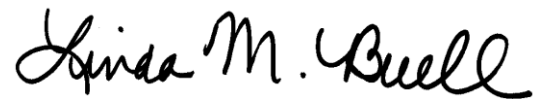
Staff acknowledges that this highly-touted tax deferral may be a good deal for IPL and its owners. However, the Illinois customers IPL leaves behind with the proposed Transaction will never receive the benefit of either the tax deferral or the new property acquisition. As such, the public will not be inconvenienced by IPL's tax deferral.

⁴ Joint Petitioners failed to mention that H.R. 2776: Renewable Energy and Energy Conservation Tax Act of 2007, which has been passed by the House but has not yet been voted on by the Senate, would extend the January 1, 2008 date to January 1, 2010.

VII. CONCLUSION

Staff believes it has set forth many compelling reasons why the Joint Petitioners' proposed Transaction does not meet the criteria set forth in Section 7-102 of the Act. For all of the foregoing reasons, Staff respectfully requests that the Commission adopt Staff's recommendations in this proceeding and not approve the Joint Petitioners' proposed Transaction.

Respectfully submitted,

A handwritten signature in black ink that reads "Linda M. Buell". The signature is written in a cursive, flowing style.

LINDA M. BUELL

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Commerce Commission

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